THE ECONOMICS OF GOVERNMENTAL PRICE REGULATION

SOME OBJECTIONS CONSIDERED

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In these days the suggestion that the government regulate prices does not arouse the apprehension that it would have fifty years ago. Today governmental price regulation is not a theoretical proposition but an accomplished fact. In an extensive field of industrial activity we are already engaged in fixing prices. The results, moreover, have not involved the disasters once prophesied, and now the question is not whether price regulation should be abolished, but whether it should be further extended so as to include the so-called industrial trusts. The great advantages of such a proposition in doing away with the evil of monopoly price and furthering a better distribution of wealth, are, I believe, generally admitted. The chief opposition thus far developed seems to be based on the argument that there are weighty objections to the measure which more than counterbalance its advantages. This morning, therefore, I shall confine myself simply to a consideration of these objections.

The seriousness and the difficult character of the task of price regulation are admitted at the start. Undoubtedly this is a measure that should not be resorted to until other less radical devices have proved inadequate. Therefore I am heartily in accord with those who say that in the case of the industrial trusts we should first do away with all forms of special privilege and unfair methods of competition. Moreover, I believe that in the vast proportion of cases this would be sufficient to curb all dangers of monopoly. Thereby, however, one of the chief objections to governmental price regulation is at once removed. There would be no such countless number of cases requiring the control of prices as has frequently been pictured, and the task of regulation would be vastly simplified. In fact there are some who claim that such measures would prove adequate to curb every trust and consequently there would be no need for price regulation at all. With this view I am unable to agree, for I believe that there are at least two classes of trusts that would still survive. First, there

are those whose strength is based on control of some natural resource, for I fail to see how the reforms suggested can hope to regulate the trusts so fortified. Second, there are those trusts where the monopoly form of organization is superior either in productive efficiency or in social value. I would emphasize the latter because it is a frequent mistake to judge the desirability of a trust solely on the basis of its productive efficiency. As yet our information is hardly sufficient to enable us to determine what this class would include. It should be borne in mind, however, that so far as the most fundamental economic characteristics are concerned it is impossible to draw any hard and fast line between public callings where monopoly has been admitted to be desirable and the industrial trusts. Not only do they blend imperceptibly into one another, but the whole trend of industrial development is in the direction of higher organization and centralization. Who will say that even now the distribution of milk or ice could not be carried on with greater productive efficiency and social value under a properly regulated monopoly than under the system of competition? The number of trusts which might come under this second class would doubtless prove to be small, but this only emphasizes the point previously made that the task of price regulation is much less of a burden than many proclaim, and that the objection based on the mere magnitude of the task is groundless.

Another objection to governmental price regulation, doubtless the most fundamental of all, is that it will tend to check individual initiative and progress. In this connection I would first raise the question whether rapidity of growth is more to be desired than soundness of growth. We all know that the most rapidly growing youth is not in the long run the most healthy. The effects of the American mania for speed at all costs are well illustrated in the industrial history of this country; we have stimulated development in innumerable ways from the first but we are now beginning to realize, to our cost, that the results are not always the most desirable. However, the other extreme of no progress would be far worse, and it must be admitted that this objection is based on very fundamental principles and deserves most thoughtful consideration. But in discussing this objection one point is generally overlooked. It should be noted that if an industry has reached the stage of monopoly then the stimulus of active competition, which is an important incentive to individual initiative and the chief force working to transfer the benefits of progress to the general

public, has already been removed whether we resort to price regulation or not. Under these circumstances a properly devised plan of price regulation becomes the best means of transmitting these benefits to the people, and furthermore it may actually prove an incentive to individual initiative as well. Much depends upon the methods used.

The first essential is to make sure that the trust is given a chance to make a reasonable profit. Just what that is, only experience and a careful study of each case will determine. All we can say is that it must be high enough to induce people to remain in the industry, or to put new capital into it if there is room for expansion. In fixing prices it will be desirable to err on the side of generosity to the trust. Not only that, but care must be taken to provide some definite and reasonable stimulus to individual initiative and progress. Increased profits arising either from improvements in technical processes or from better organization and business methods must not be snatched away at once by compelling a corresponding reduction in price. It should be a definite policy to permit a concern to keep a portion, if not all, of the extra profits arising from such improvements for a period of time, though in the long run the gain must be transmitted to the consumer through a reduction in price. The extra margin of profit obtained in the meantime will be a sufficient inducement to secure progress. This is shown by the fact that our present attempts at price regulation work out in substantially this same way. There is no attempt at an exact adjustment of prices and the profits from improvements accrue in the main to the producer. Moreover, our actual experience in the cases of railroads, gas, electric light, and similar concerns does not indicate that the incentives for progress have been removed by price regulation. Surely there is no serious general demand that we abandon our present practice for the sake of securing more rapid progress in these industries. Nor does this experience show any ground for the fear that capital will fly the field of industry where prices are regulated. It probably does keep out purely speculative capital, but sound business enterprise has not been scared away. In fact there is a conceivable danger on the other side. The plan must not be made too attractive to promoters and monopolists. There can be no guarantee of fair profits, simply an opportunity open to anybody with average management. If the trust is inefficient the field is free to others, and it should be noted that in the case of industrials the monopoly is

much more open to attack and so will ordinarily have a greater incentive for efficiency than most public service companies.

As a working scheme, probably the most effective method to secure both efficiency and reasonable prices is that whereby a standard price and rate of profit is determined upon, a reserve fund created, and then for every decrease in price of a given amount an increase in profits is allowed to the owners, the standard being revised periodically; such, for instance, as is used in the case of the Boston Gas Company. Given the existence of monopoly, I am firmly convinced that such a scheme actually offers an even greater incentive for improvement than no price regulation. This plan, however, requires a very careful adjustment in the first place, and probably is not adaptable to many lines of industry. A more elastic and usable scheme would be to fix a maximum price, one somewhat above what might be expected to be the average price yielding a fair profit, and then tax progressively all profits above a given rate, proper allowances being made for the accumulation of a reserve. The suggestion that taxation of profits alone be used is not discussed because, in spite of avoiding the difficulty of price fixing, it has two fundamental defects in failing to afford incentive for progress and in not adequately meeting the crucial evil of distribution.

Another objection raised is that the price regulation will be too difficult and intricate a problem for a government commission. Of course this ignores the fact that we are already working out just this problem in the case of the public service companies, where the results, if not perfect, certainly are not a failure. But would it be more difficult in the case of the industrials? In some instances it would be easier. Thus there are few commodities where there is less to guide one and where the costs of production can not be far more definitely determined than in the case of a railroad rate. Admittedly, however, fixing the price of commodities will involve more difficulties than now arise in connection with gas, electric light or street railway companies. Doubtless more would depend upon the decision made in the case of an important commodity than in that of a single railroad rate, but the number of decisions would be smaller in the case of industrials and the importance of some general rate decisions is quite as great as that which might be involved in almost any commodity. Another advantage of industrials is that by affording freer opportunity for potential competition they would require less control over quality of the service.

On the other hand, there are certain respects in which price regulation of industrials will be more difficult than in the case of public service companies. Even with the increased stability that may be expected to come from monopoly, the industrials are subject to more frequent fluctuations in prices. But, if the government simply fixes a maximum price, above what may be expected to be the average, then there is room for fluctuations to meet the varying conditions of trade, and there will be no necessity for the government's determining every change. Nevertheless, it must be admitted that revision of the maximum price will have to be made more frequently than in the case of public service companies.

Another difficulty arises in making sure that the adjustment of prices is based on the costs under reasonably efficient management. In the case of public utilities, such as gas, street railway or electric light companies, the business is becoming standardized and the monopoly is localized so we can compare the efficiency of different concerns and have some basis for testing the management. But an industrial monopoly is likely to combine nearly all the plants producing the commodity under one management. These plants will vary among themselves and thus afford some basis for comparison, but special care will have to be taken to make sure that inefficient management is not accepted as a basis for price regulation. This difficulty, however, is in a considerable measure offset by the fact that, unlike the public service companies, few industrials have a complete monopoly; there are generally some independent concerns and there is always greater opportunity for new competition to develop in these industries, all of which features afford an important check on inefficiency, and one such as is seldom available in the case of the public service companies.

Still another objection frequently given great weight is that if we begin to regulate the price of a commodity it will eventually involve regulating the wages of the labor employed. Since the value of the agents of production is derived from the value of the finished products, it might appear that fixing the price of the product would determine the value of the labor employed in producing it. If a given class of labor could be used only for one product this would be true. In fact, however, the demand for most of this labor comes from many sources; it is a composite demand, and that arising from any one commodity is a negligible factor. We can not deny any influence, but, practically, it is so slight that it can be ignored. The prices fixed in the general

market afforded by the many other sources of demand offer a sufficient basis on which to proceed in fixing prices. Experience, moreover, justifies this conclusion. In the case of public service companies wages have fluctuated up and down when there were no changes in rates, but any distinct and fairly permanent change in the market price of labor is recognized in fixing rates. This objection, therefore, is one which need not make us hesitate in resorting to price regulation.

So far, then, as this hasty review of some of the chief objections raised against governmental price regulation in the case of industrial trusts covers the question, I conclude that since our present experience in the regulation of public service companies has met with reasonable success, there being no indication that it is likely to be abandoned; and since there is no reason for believing the problem would be much more difficult in the case of the few industrial trusts where other remedies are inadequate,—therefore we are not justified in condemning governmental price regulation on the basis of these objections.

Finally, it must not be forgotten that the evil we are attempting to remedy involves one of the most serious economic problems of the day. While I have confined myself to an attempt to show that the objections to governmental price regulation in the case of industrial trusts are not much more serious than in other cases where the same policy is admitted to be desirable, it does not follow that price regulation is to be condemned, even if one is not convinced of the soundness of my position. In such problems there is no remedy which does not involve some difficulties, and it is always a question of balancing the objections and advantages on both sides. Thus in this case, where the existing evil is so very grave, a measure which promises to control it may still be well justified even though the existence of great difficulties were universally conceded.